

DIRECT TESTIMONY

OF

Thomas Q. Smith

Water Department

Financial Analysis Division

Illinois Commerce Commission

Illinois-American Water Company and South Beloit Water Gas & Electric Company

Petition for Approval of Proposed Reorganization

Docket No. 05-0724

March 31, 2006

OFFICIAL FILE

ICC DOCKET NO. 05-0724

Staff Exhibit No. 1.0

Witness

Date 4/7/06 Recorder Dfr

1 WITNESS IDENTIFICATION

2 Q. Please state your name and business address.

3 A. My name is Thomas Q. Smith. My business address is 527 East Capitol Avenue,  
4 Springfield, Illinois 62701.

5  
6 Q. Please describe your present position and related responsibilities.

7 A. I am presently employed as an Economic Analyst in the Water Department of the  
8 Financial Analysis Division of the Illinois Commerce Commission ("ICC" or the  
9 "Commission"). My responsibilities include reviewing and analyzing tariff filings  
10 related to rates, rules, regulations, and conditions of utility service; reviewing  
11 applications for certificates of public convenience and necessity; reviewing  
12 information regarding the prudence of Qualifying Infrastructure Plant ("QIP")  
13 investment costs; conducting inspections of water and sewer public utilities;  
14 reviewing requests for general increases in rates for water and sewer service;  
15 reviewing tariff filings related to purchased water surcharge riders and  
16 information sheets; and presenting expert witness testimony in docketed  
17 proceedings before the Commission. Prior to my transfer to the Water  
18 Department, I served as an auditor in the Commission's Accounting Department.

19  
20 Q. Please describe your background and professional qualifications.

21 A. In 1974, I received a Bachelor of Arts Degree in Accounting from Michigan State  
22 University. I am a Certified Public Accountant licensed to practice in Illinois,  
23 Michigan, and Wisconsin. My prior experience includes seven years as an

auditor with the Michigan Public Service Commission. Subsequently, I was employed for three years by Wisconsin Southern Gas Company in the initial capacity of Senior Accountant - Rate Specialist and later as Controller. I am a member of the American Institute of Certified Public Accountants.

Q. Have you previously testified before regulatory bodies?

A. Yes, I have testified on many occasions before the Illinois Commerce Commission, the Michigan Public Service Commission, and the Public Service Commission of Wisconsin. During the course of various rate proceedings I have testified to accounting, rate, cost of service, finance, and operational issues.

PURPOSE OF TESTIMONY

Q. What is the purpose of this proceeding?

A. The purpose of this proceeding is to consider the request of Illinois-American Water Company ("IAWC") and South Beloit Water Gas & Electric Company ("South Beloit") (jointly "Joint Applicants") for approval of the sale of water system assets from South Beloit to IAWC; to consider the request of IAWC for a Certificate of Public Convenience and Necessity to provide water service in the area currently served by South Beloit; to consider the request of South Beloit to abandon the provision of water service in Illinois; to consider IAWC's request for approval of various accounting entries related to the transfer of assets; to consider IAWC's request to serve current South Beloit customers under South Beloit's schedule of rates and rules for water service, Ill. C. C. No. 9; and to

47 consider IAWC's proposal to assume South Beloit's rights and obligations under  
48 the Agreement to Provide Wholesale Water Services to South Beloit Water Gas,  
49 and Electric Company.

50  
51 Q. What is the purpose of your testimony?

52 A. The purpose of this testimony is to present my recommendations to the  
53 Commission regarding the proposed transfer of the South Beloit water system to  
54 IAWC, the issuance of a Certificate of Public Convenience and Necessity to  
55 IAWC, abandonment of the South Beloit Water system by South Beloit, and rules  
56 and regulations to be applicable to the South Beloit water system following its  
57 transfer.

58  
59 Q. Have you reviewed the Joint Applicants' positions in this proceeding?

60 A. Yes, I have. I have reviewed the Verified Second Amended Application. I have  
61 read the Direct Testimonies of Michael J. Hoffman, IAWC EXHIBIT NO. MJH-1.0;  
62 Bob Khan, IAWC EXHIBIT NO. BK-1.0; Barbara A. Siehr, SBWGE Exhibit (BAS-  
63 1); and Richard E. Potter, SBWGE Exhibit (REP-1). I have reviewed the  
64 Supplemental Direct Testimony of Richard E. Potter, SBWGE Exhibit (REP-2). I  
65 have reviewed the Revised Supplemental Direct Testimony of Bob Khan, IAWC  
66 EXHIBIT NO. BK-2.0R. I have analyzed the Joint Applicants' responses to  
67 various data requests. I also conducted an on-site inspection of the South Beloit  
68 water distribution system January 10, 2006.

70 JOINT APPLICANTS' REQUESTS

71 Q. What are the Joint Applicants to this proceeding requesting?

72 A. The Joint Applicants are requesting approval of a transfer of South Beloit's water  
73 assets to IAWC under Sections 7-102 and 7-204 of the Illinois Public Utilities Act  
74 (the "Act"). Additionally, South Beloit is requesting approval to abandon its water  
75 operations under Section 8-508 of the Act, and IAWC is requesting a Certificate  
76 of Public Convenience and Necessity ("Certificate") to operate a water system  
77 under Section 8-406 of the Act.

78

79 SECTION 7-102 OF THE ACT

80 Q. Are you familiar with the requirements of Section 7-102 of the Act?

81 A. Yes, I am. Section 7-102 requires Commission consent and approval prior to  
82 one public utility transferring or selling assets and/or operations to any other  
83 public utility. In this proceeding it is my opinion that South Beloit and IAWC must  
84 obtain the approval of the Commission prior to executing the provisions of the  
85 Joint Applicants' contract to transfer South Beloit's water assets and operations  
86 to IAWC. The specific requirements that must be achieved in order to obtain the  
87 Commission's approval are enumerated in subsequent portions of my Direct  
88 Testimony.

89

90 SECTION 7-204 OF THE ACT

91 Q. What requirements of Section 7-204 of the Act are you addressing?

92 A. I am addressing Section 7-204(b)(1), Section 7-204(b)(5), and Section 7-  
93 204(b)(6) of the Act.

94

95 Q. Section 7-204(b)(1) of the Act states, "the proposed reorganization will not  
96 diminish the utility's ability to provide adequate, reliable, efficient, safe and least-  
97 cost public utility service." Are you aware of any evidence that indicates that  
98 ownership by IAWC diminishes the ability of the public utility to provide adequate,  
99 reliable, efficient, safe and least-cost service to its customers?

100 A. I am aware of no evidence that indicates that the reorganization will hinder the  
101 utility's ability to provide high quality service as defined in Section 7-204(b)(1) of  
102 the Act. IAWC is the largest investor-owned water utility in the state. It currently  
103 provides water service to more than 250,000 customers in approximately 20  
104 separate operating systems. It is reasonable to expect that IAWC can provide  
105 water service as required by Section 7-204(b)(1) to the approximately 2,300  
106 customers in the South Beloit service area. Additionally, Company witness Khan  
107 has indicated in his Direct Testimony, IAWC EXHIBIT NO. BK-1.0, lines 98  
108 through 106, that IAWC is capable of providing service as required by Section 7-  
109 204(b)(1).

110

111 Q. Section 7-204(b)(5) of the Act requires that all utilities "...remain subject to  
112 applicable laws, regulations, rules, decisions and policies governing the  
113 regulation of Illinois public utilities." Do you expect that the South Beloit water

114 system will remain subject to the laws regulating water utilities when the transfer  
115 to IAWC is complete?

116 A. I know of no reason why the South Beloit water system under IAWC ownership  
117 would cease to be subject to Illinois regulatory law. Additionally, Mr. Khan's  
118 Direct Testimony, lines 79 through 82, indicates that IAWC expects the South  
119 Beloit system to remain subject to Illinois regulatory law.

120

121 Q. Section 7-204(b)(6) of the Act allows for a reorganization if it "...is not likely to  
122 have a significant adverse effect on competition in those markets over which the  
123 Commission has jurisdiction." Is this reorganization likely to have a significant  
124 adverse effect on competition?

125 A. No. The South Beloit Water System bills approximately \$540,000 in revenues  
126 annually. The Commission regulates utilities with a total of approximately  
127 \$190,000,000 in revenues. Because of South Beloit's size, the potential impact,  
128 if any, on competition resulting from its sale to IAWC would be *de minimis*.  
129 Additionally, Mr. Khan's Direct Testimony, lines 107-113, states that due to the  
130 geographical separation of the service areas, there is no significant competition  
131 for water sales between South Beloit and IAWC. As such, Mr. Khan indicates  
132 that market conditions in Illinois after the consummation of the reorganization will  
133 be substantially the same as they currently exist.

134

135

136

137 SECTION 8-406 OF THE ACT

138 Q. Item 7 of the Verified Second Amended Application indicates that the Joint  
139 Applicants are requesting that a Certificate of Public Convenience and Necessity  
140 be granted to IAWC to operate a water system to serve customers currently  
141 being served by South Beloit. Do you agree that a Certificate must be granted to  
142 IAWC before it can operate the South Beloit system?

143 A. Yes, I do. Section 8-406 of the Public Utilities Act requires:

144 No public utility not owning any city or village franchise nor  
145 engaged in performing any public service or in furnishing any  
146 product or commodity within this State as of July 1, 1921 and  
147 not possessing a certificate of public convenience and  
148 necessity from the Illinois Commerce Commission, the State  
149 Public Utilities Commission or the Public Utilities  
150 Commission, at the time this amendatory Act of 1985 goes  
151 into effect, shall transact any business in this State until it  
152 shall have obtained a certificate from the Commission that  
153 public convenience and necessity require the transaction of  
154 such business.  
155

156 It is clear that IAWC must possess a Certificate in order to legally operate the  
157 South Beloit Water system.

158

159 Q. Are you familiar with the area for which a Certificate is being sought?

160 A. Based on the physical inspection that I performed, I am generally familiar with the  
161 service area. Additionally, Mr. Bob Khan in his Revised Supplemental Direct  
162 Testimony, IAWC EXHIBIT NO. BK-2.0R, page 1, describes the area for which  
163 IAWC requests a Certificate as corresponding to the area in which South Beloit  
164 currently provides water service, plus areas abutting the current service area.  
165 The area for which a Certificate is being requested is more completely described



166 by a map, and a metes and bounds description, attached to Mr. Khan's Revised  
167 Supplemental Direct Testimony as IAWC Exhibit No. BK-2.1 and IAWC Exhibit  
168 No. BK-2.2, respectively.

169  
170 Q. Do any other water utilities provide water utility service to the area for which a  
171 Certificate is being requested?

172 A. Based on my knowledge and understanding, as supported by the Joint  
173 Applicants' representations, I am aware of no utility that is currently providing  
174 water service in the South Beloit service territory that has an interest in providing  
175 water utility service in the area, or that has a least cost capability of providing  
176 water utility service in the area.

177  
178 Q. Do you believe that it is reasonable for the Commission to approve a Certificate  
179 of Public Convenience and Necessity for IAWC to provide water service in the  
180 area identified in IAWC Exhibit No. 2.1 and IAWC Exhibit No. 2.2 as attached to  
181 Mr. Khan's Revised Supplemental Direct Testimony?

182 A. Yes, I do. South Beloit is requesting authority to abandon service, and IAWC is  
183 requesting authority to provide service. IAWC is capable of operating and  
184 managing the South Beloit system, no other entity is reasonably capable of  
185 providing service in the South Beloit service area. Therefore, it is reasonable  
186 that IAWC be granted a Certificate under Section 8-406 of the Act to provide  
187 water service in the current South Beloit Water service area as that area is  
188 defined by the map and the metes and bounds description, contained in IAWC

Exhibit No. 2.1 and IAWC Exhibit 2.2 as attached to Mr. Khan's Revised  
Supplemental Direct Testimony.

Q. Why is it necessary for IAWC to request a Certificate under Section 8-406 of the  
Act; rather than transferring the Certificate currently held by South Beloit, as is  
normally done when one utility acquires the operating system of a second utility?

A. As discussed in Mr. Potter's Supplemental Direct Testimony, SBWGE Exhibit  
(REP-1), page 3, South Beloit, after conducting a thorough search, is not aware  
of any existing Certificate that identifies the area that is currently being served by  
South Beloit. As Mr. Potter further explains, because of grandfathering  
provisions in the Act, it is reasonable to expect that no Certificate has been  
granted to South Beloit, and in any case, the Joint Applicants and Commission  
Staff are unaware of the existence of any Certificate that could be transferred. In  
my opinion, it is necessary that IAWC be granted a Certificate to serve the area  
currently served by South Beloit prior to transacting business.

SECTION 8-508 OF THE ACT

Q. Item 8 of the Verified Second Amended Application indicates that the Joint  
Applicants are requesting that South Beloit be permitted to abandon its water  
service operations in South Beloit. Do you agree that approval of the  
Commission is required prior to the abandonment of water operations by South  
Beloit?

211 Q. Yes, I do agree. Section 8-508 of the Act states in part, "[e]xcept as provided in  
212 Section 12-306, no public utility shall abandon or discontinue any service  
213 ...without first having secured the approval of the Commission..." The approval  
214 of the Commission is axiomatic.

215

216 Q. Do you believe that it is appropriate for the Commission to grant its approval for  
217 South Beloit to abandon its water system?

218 A. Yes, I do. South Beloit is selling its water system to IAWC which will in turn  
219 operate that water system. Thus, there is no need for South Beloit to operate the  
220 water system and authority for South Beloit to abandon that system should be  
221 granted.

222

223 APPLICABLE RULES AND REGULATIONS

224 Q. In IAWC EXHIBIT NO. BK-1.0, lines 73 through 78, IAWC proposes to serve  
225 customers in the current South Beloit service territory under the rules and  
226 regulations under which those customers are currently served. Do you agree  
227 with this proposal?

228 A. Yes, I do. I have seen no evidence to indicate that South Beloit's customers are  
229 ill-served by the current rules and regulations. It is my opinion that IAWC should  
230 assume the rules and regulations contained in Ill. C. C. No. 9 and currently  
231 applicable to South Beloit's water customers, and that those rules and  
232 regulations remain in effect until such time that the Commission might authorize  
233 new rules and regulations.

234 RECOMMENDATIONS AND CONCLUSION

235 Q. Are you expressing an opinion on the financial resources of IAWC relative to its  
236 ability to acquire and operate South Beloit's water operations?

237 A. No, I am not. Staff witness Mike McNally is testifying to the financial resources of  
238 IAWC.

239

240 Q. Are you addressing accounting and rate issues at issue in this proceeding?

241 A. No, I am not. Staff witness Mary Everson is addressing accounting issues,  
242 including the proposed transfer of the Agreement to Provide Wholesale Water  
243 Services, and Staff witness Mike Luth is addressing rate issues.

244

245 Q. What is your recommendation at this time?

246 A. I recommend that the proposed sale of the South Beloit water system by South  
247 Beloit to IAWC be approved, that a Certificate of Public Convenience and  
248 Necessity be granted to IAWC to operate the South Beloit water system, that  
249 South Beloit be granted authority to abandon the South Beloit water system, and  
250 that the rules and regulations currently applicable to the South Beloit water  
251 system under applicable tariffs continue to be applicable to the South Beloit  
252 water system after it is transferred to IAWC.

253

254 Q. Does this conclude your direct testimony?

255 A. Yes, it does.